No. 21002

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD R. CLEMENTS, Trustee in Bankruptcy of the Estate of Jesse E. Caton, dba CATON PRODUCTION MACHINES,

Appellant,

vs.

PASADENA FINANCE COMPANY, a California corporation, *et al.,*

Appellee.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

Appellee, Pasadena Finance Company, upon motion pursuant to Rules 12 and 56 of the Federal Rules of Civil Procedure, was granted a summary judgment of dismissal in an action by the Appellant Trustee in Bankruptcy of Jesse E. Caton, dba Caton Production Machines (hereinafter called Caton).

Richard R. Clements, the Trustee Appellant, brought this action under Sections 60 and 70e of the Bankruptcy Act (Secs. 96 and 110e of Title 11, U.S.C.A.) to recover certain machinery, vehicles and equipment which Caton had sold to United States Machinery Company and immediately leased back from such company under a written lease.

United States Machinery Company thereupon sold its rights as lessor to Appellee Pasadena Finance Company. Later, on May 26, 1965, Caton surrendered the machinery and equipment up to Appellee while Caton was in default in making payments under the lease. Within four months after surrendering such property up to Appellee, Caton filed a voluntary petition in bankruptcy.

Appellee's motion for a summary judgment was supported by an affidavit of its Vice President, Lyle Adrianse, which showed that the leasing transaction and the transfer of the lease to Appellee had been handled through an escrow at First Western Bank and Trust Company, which bank handled the notice of sale. Nothing in such affidavit is opposed to the allegations in the Complaint. It merely sets forth, as exhibits, the copies of the crucial writings, and Appellant never made any attempt to challenge any statements in the Adrianse affidavit, so the case involves nothing but questions of law as to the interpretation of Section 3440(h)(2) of the Civil Code.

There is no basis for any liability on the part of Appellee, and the escrow instructions containing the ten-day notice, as required by Section 3440(h)(2), do not impose any liability upon Appellee. In fact, if there was any liability on the part of anyone, it would be on the part of First Western Bank and Trust Company, the party who acted as escrow agent in the transaction and who recorded the Notice of Transfer and Lease Back.

Statement of the Case.

The question in this case resolves into whether the notice under Section 3440(h)(2), which the escrow agent gave, was sufficient, or whether the notice was one

day short of the statutory requirement. If it was short, then did this invalidate the Appellee's rights under the lease contract? If the ten-day notice was timely given, Appellee acquired its vested rights which entitled it to repossess the equipment within the four-month period prior to bankruptcy.

If the notice was too short under Section 3440(h)(2), then Appellant says that the repossession by Appellee of the equipment, under the terms of the lease, would have constituted a voidable preference. Appellant also contends that a full period of ten days' notice was not provided for by First Western Bank and Trust Company, so Appellant claims that the notice was too short.

On August 7, 1964, the transaction was implemented by escrow instructions signed by Appellee and the United States Machinery Company. [Ex. 1 to Adrianse Affidavit.]

Exhibit 3 to the Adrianse affidavit, designated as "Notice of Intended Sale", shows a recording time of 3:30 P.M. on August 10, 1964. This notice was executed and recorded pursuant to Section 3440.1 of the Civil Code, and Appellant's attack does not seem to be predicated upon any defects regarding this notice.

The asserted defect in timing relates to the "Notice of Intended Transfer and Leaseback", attached to the Adrianse affidavit as Exhibit 4 which shows a recording date of 3:30 P.M. on August 10, 1964.

We do not believe that this transaction was of the type which required compliance with the notice requirements of Section 3440.1, since it did not involve a sale or assignment of a stock in trade. It related to a transfer of precision machinery in a machine shop.

This is not a matter to which we need to devote further time, because it is conceded that the provisions of Section 3440(h)(2) do apply, and the notice required with respect to a sale and lease back under those provisions would govern in any event. It should be added that the time requirements of Sections 3440.1 and 3440-(h)(2) are identical in any event, so that if the period of notice was insufficient under one section, it could likewise be insufficient under the other.

Section 3440(h)(2) is a part of a comprehensive law dealing with various transfers. Section 3440 begins by declaring transfers to be void when there is no actual physical change of possession. The provisions of subdivisions (h)(2) cover an exception to this requirement that there be a physical change of possession where the transferor immediately or concurrently leases back the machinery and equipment from the transferee. Such provisions cover a transaction which is, in effect, a financing transaction, in that the owner of the equipment transfers the equipment to another party which, in turn, leases the equipment back to the owner on a monthly rental basis. These monthly rental payments are periodically receved in payment of the moneys for which the owner originally sold the equipment to the financing company. In other words, the transaction, by its very nature, was never intended to involve a transfer of physical possession to anyone. It merely made possible an arrangement whereby an owner received money for the purported sale of equipment and then paid back such money on a monthly basis while such owner continued to possess and utilize the equipment in the owner's plant.

The bill of sale to the machinery and equipment is dated August 20, 1964, and was concededly delivered by

the escrow agent to the United States Machinery Company at that time. [Ex. 5 to Adrianse affidavit.] At the same time, the United States Machinery Company caused all of this machinery to be leased back to Caton [Ex. 7 to Adrianse affidavit], and also assigned its lessor's interest therein to Appellee. [Ex. 8 to Adrianse affidavit.]

Simultaneously, the United States Machinery Company signed a bill of sale assigning its ownership in the machinery to Appellee. [Ex. 6 to Adrianse affidavit.]

It is this sale and lease back transaction which was initiated by the recording of the Notice of Intended Transfer and Leaseback, recorded on August 10, 1964, at 3:30 P.M., and consummated by the delivery of the documents described in the two preceding paragraphs which Appellant is now attacking. Appellant argues that ten days did not elapse between 3:30 P.M., August 10th, and 10:00 A.M., August 20th, the date of the consummation of the escrow [Adrianse affidavit, Para. 12, p. 4], so from this assumption, Appellant asserts that Appellee had no valid ownership in, or rights to accept the return of, the machinery within four months of Caton's bankruptcy on June 11, 1965, bearing in mind that it was on May 26, 1965, when Appellee received the return of the machinery. [Complaint, p. 3, line 1.]

Appellee contends that a portion of a day is legally considered as a full day and that the ten-day notice requirement was complied with, so that Appellee was not a mere general creditor at the time it re-acquired possession of the machinery on May 26, 1965. On the contrary, it had a valid right to repossess the machinery by reason of Caton's defaults in the payment of rentals under the lease back.

There is one other possible matter which should be mentioned, and this is that, at the time the machinery was repossessed, there was no equity over and above the amount still owed Appellee under the lease. Neither did Appellant proceed on any such basis or that Appellant wished to have time to endeavor to dispose of the machinery for more than the unpaid rental to Appellee. In spite of this and as a precautionary measure, Appellee filed an affidavit of a W. M. Darnell, an expert on machinery values, which shows the value of the machinery to be less than the balance due under the so-called lease back. The affidavit of W. M. Darnell shows that the market value of the equipment at the time of its repossession by Pasadena Finance Company was $16,156.00, and the affidavit of Lyle Adrianse shows that at the time of its repossession, there was unpaid under the lease back the sum of $25,906.00, resulting in a *deficiency* of approximately $12,000.00.

In this connection, Appellee cites *8A Corpus Juris Secundum,* Section 220(5) at pages 120 and 121 (Note 67), to the effect that a valid lien creditor who repossesses property during the four-month period before bankruptcy is not subject to attack by the trustee, unless there has been a substantial excess in value of the equipment which was repossessed over the amount of the indebtedness secured thereby. Unless there is such substantial difference, there is no diminution of the estate which the trustee can attack. On this same point, see *Collier Bankruptcy Manual,* 2d Ed., pages 522 and 523, Subsections (2) and (3).

With the foregoing facts, it becomes merely a matter of construing the provisions of Section 3440(h)(2).

ARGUMENT.

I.

The Law of the State Governs the Construction of Section 3440(h)(2).

See: *Erie R. Co. v. Thompkins,* 304 U.S. 64, 58 S. Ct. 817.

It is true that the provisions of the Bankruptcy Act may govern matters relating to time when fixed by a bankruptcy statute, such as the four-month period within which to attack a voidable transfer, and time relating to a final discharge.

Where a state statute is being applied, it is construed in accordance with the state law.

See:

Bankruptcy Act, Section 31 (Sec. 54, Title 11, U.S.C.A.); and

Rule 6a, Federal Rules of Civil Procedure.

On the other hand, the construction of a state law, such as Section 3440(h)(2), is governed by state law.

See:

In re Aerocolor, Inc. (U.S.D.C. S.D. Cal. C.D.), 236 Fed. Supp. 84; and

Edwards v. McCullough (U.S.D.C. W.D. Ky.), 114 Fed. Supp. 766.

II.

Section 3440(h)(2) of the Civil Code Was Designed to Cover a Sale and Lease Back Such as the One Involved in This Case.

Appellee will now discuss the law which shows that proper notice of such sale and lease back was given, so that there is no liability on which Appellant is entitled to recover against anyone. This is not only demonstrated by the allegations in Appellant's Complaint, which show that the notice required by Section 3440-(h)(2) was recorded on August 10, 1964, and that the assignment and lease back took place on August 20, 1964, but it is even more specifically shown from the documents relating to the escrow, handled at First Western Bank and Trust Company, which are attached to the Affidavit of Lyle A. Adrianse, an officer of Appellee, Pasadena Finance Company. These documents show conclusively that the notice was recorded by First Western Bank and Trust Company on August 10, 1964, and that the transaction took place on August 20th, so that there was a ten-day period which transpired within the meaning and requirements of Section 3440(h)(2).

Clearly, the above statute applies, since the transaction was one in which the bankrupt assigned and transferred all of the machinery and equipment to the United States Machinery Company, which, in turn, entered into a written lease under which it leased back to the bankrupt all such machinery and equipment, and in the same escrow, United States Machinery Company assigned its rights, as lessor under the lease, together with all of its rights and ownership in and to the machinery and equipment, to Appellee. It is this type of transaction, wherein possession of the machinery and equipment

never leaves the bankrupt, that Section 3440(h)(2) is designed to cover, as Subd. (2) states:

> "The transferor (lessee) or the transferee (lessor) records at least 10 days before the date of the transfer and leaseback in the office of the county recorder in the county or counties in which the personal property is situated, a notice of the intended transfer and leaseback which states the name and address of the transferor (lessee) and transferee (lessor). The notice shall contain a general statement of the character of the personal property intended to be transferred and leased back, and show the date when and place where the transaction is to be consummated."

III.

The Notice Required by the Statute in Connection With the Sale and Lease Back Was Valid.

The Escrow Instructions [Ex. 1 to Adrianse affidavit] were dated August 7, 1964, and the directions which the two parties to such escrow, that is, the bankrupt and United States Machinery Company, gave to First Western Bank and Trust Company, the escrow agent, were in the language of Section 3440(h)(2) of the Civil Code, in that the said escrow agent was instructed to record "at least ten (10) days before date specified for sale" a Notice of Intended Transfer and Leaseback. This Notice [Ex. 4 to Adrianse affidavit] shows the County Recorder's recording stamp of August 10, 1964, at the hour of 3:30 o'clock P.M. This Notice also shows that the date specified therein for closing the escrow was August 20, 1964, and it is conceded that the escrow was closed and the bill of sale and

lease back were delivered by the escrow agent on August 20, 1964, to the parties entitled thereto.

All of the cases dealing with language, such as that contained in Section 3440(h)(2) of the Civil Code, have construed it to require that the date on which the notice was recorded is excluded in computing the ten-day period, and the date of the delivery or closing of the escrow may be included in computing such ten-day period. The rule is stated in *Section 10* of the California Civil Code as follows:

> *"Computation of time.* The time in which any act provided by law is to be done is computed by excluding the first day and including the last, unless the last is a holiday, and then it is also excluded."

The same rule is stated in *47 Cal. Jur. 2d* (Time) under Section 10 at page 670 as follows:

> "The general rule is that fractions of a day are not considered in the computation of time, and that the day on which an act is done must be either excluded or included in its entirety. Accordingly, where the law fixes the time within which an act is to be done, all of the last day of that period is within the time. Any other method computation would require the keeping of an accurate account of the exact hour, minute, and second of the occurrence of the act to be timed, would produce endless confusion and strife, and would prove impolitic, if not wholly impracticable."

It is further stated under *Section 11* of 47 Cal. Jur. 2d at page 672 as follows:

> "It is provided by law that the time within which any act provided by law is to be done is computed

by excluding the first day and including the last, unless the last is a holiday, and then it also is excluded. This is the general or ordinary rule for the computation of time. Before a given case will be deemed to come within an exception, the intention must be clearly expressed to provide a different method of computation."

The above rules are not restricted merely to procedure but are applicable to any act required by law, unless the particular statute specifically requires the application of a different rule.

See:

47 Cal. Jur. 2d (Time), Section 12, p. 673.

For decisions holding that, in counting time, the first day is excluded and the last day is included, see:

Union Oil Co. v. Domengeaux, 30 Cal. App. 2d 266 at 272 and 273;

Reichardt v. Reichardt, 186 Cal. App. 2d 808 and 809 and 810; and

Ley v. Dominguez, 212 Cal. 587 at 594.

Each of the above cases also states the rule that in order to apply a different method of computing time, the intention of the statute involved must be clearly shown.

No authority sustains Appellant's position that the required ten-day period of notice did not expire, as required by the statute.

Appellant relies upon a single decision, which is a typical example of applying another method of counting time, because the specific statute involved required this. That case is *City of Pleasanton v. Bryant,* 63 A.C. No. 23,673. In such case, the court was inter-

preting Section 34302.6 of the Government Code involving incorporation of municipalities. The statute, in specifying time, used the words "For a period of 90 days after the filing of such notice of intention (to incorporate)". The court, in explaining its decision, said at page 676:

> "The first notice was filed on January 18, 1963; and the period of 90 days *after* January 18 included April 18, 1963. Thus the second notice of intention, filed April 18, 1963, was one day premature. This conclusion is supported by Municipal Imp. Co. v. Thompson (1927) 201 Cal. 629 (258 P. 955), relied upon by the Dublin Group. The language of the statute there considered differed from that now before us, but the court noted (p. 632) that if that statute had 'read that the objections should be heard at least "twenty days *after* the posting of notices,"' (italics added), then the first day (September 25) would be excluded and the last day (October 15) included, the prescribed 20-day waiting period would intervene, and the hearing held October 15 would have been one day early. Thompson further declares that 'The law takes no notice of fractions of a day. Any fraction of a day is deemed a day unless in a particular case it is necessary to ascertain the relative order of occurrences on the same day.' (See also Reichardt v. Riechardt (1960) 186 Cal. App. 2d 808, 810 (9 Cal. Rptr. 225).)"

In the above-quoted language, the court cites with approval the *Reichardt* case, *supra,* which we have already hereinabove cited in support of the rule applicable to this type of transaction.

IV.

Even Though the Documents Should Not Have Been Delivered Until a Day Later, Appellant Has Shown No Prejudice Entitling Appellant to Attach the Sale and Lease Back Which Was Supported by an Adequate Consideration.

There is no contention by Appellant that the moneys paid through the escrow on August 20, 1964, were not an adequate consideration. Furthermore, there is no contention that at the time of such sale and lease back, there was any intention to dispose of the machinery and equipment for less than its reasonable value. Likewise, Appellant is not contending that Appellant actually suffered any prejudice by reason of the papers being delivered on August 20, 1964, the date specified in the Notice of Intended Transfer and Leaseback which was recorded August 10, 1964 [Ex. 4 to Adrianse affidavit].

In the case of *Aerocolor, Inc.* (D.C. Cal. S.D. C.D. 1964) 236 Fed. Supp. 84, the court, in holding the transfer to be valid, said at page 87:

> "The Referee found that the consideration for the chattel mortgages and the delivery of the chattel mortgages were not in accordance with the provisions of Section 3440.1 of the California Civil Code in that the mortgages were recorded 15 minutes prior to the time designated in the notice of intention to mortgage.
>
> The record does not reveal just when the consideration was paid or just when the chattel mortgages were actually delivered. All it does show is that the challetel mortgages were recorded 15 minutes before the time designated in the notice.

> "In the absence of any showing of prejudice on the part of any creditor, I conclude that there has been a substantial compliance with Section 3440.1 of the California Code. In the absence of a further showing as to the time at which the consideration changed hands, the presumption of validity should support this holding. The object of this Section in the Civil Code is to furnish creditors of the intended mortgagor a period of at least ten days within which to levy attachment or execution on the property to be mortgaged and to garnishee or levy on the proceeds of the mortgage in the event payment is not made on the claims presented. There is no showing that the premature recordation of the chattel mortgages has in any way frustrated the object of the statute or prejudiced the rights of the creditors * * *."

In the above decision, the court did not discuss or go into the question of measuring periods of time. It was not concerned with how time is counted, because the question there was whether the recording of the documents 15 minutes prior to the time stated in the notice invalidated the transaction. In other words, it was a question whether failure to record exactly on the hour specified in the notice invalidated the transaction, and the court held that this did not.

For other cases indicating that a transaction, in the absence of prejudice, would not be set aside even though there had not been strict compliance with Section 3440 (h)(2), see:

In re Lundgren Wood Products, 198 Fed. Supp. 908; and

Dersch v. Thomas, 138 Cal. App. Supp. 785 at 789.

Conclusion.

The burden of attacking the validity of the sale and lease back has always been on Appellant. In spite of his failure to sustain such burden, Appellant has shown no grounds upon which the recovery by Appellee of the equipment could constitute a voidable preference. On the contrary, Appellant has disregarded the wealth of statutory interpretation in this field and has endeavored to utilize a decision which has utterly nothing to do with liens of the type involved herein or with the measurement of time for giving notice, as required by the law relating thereto. The fact that Appellant has been forced to go so far afield and attempt to rely upon the *City of Pleasanton v. Bryant, supra,* is indicative of the destitution of Appellant's position in this case.

We believe that the Court should put an end to this litigation by affirming the decree granting the motion for summary judgment, and by ruling in accordance with the numerous interpretations which have existed with respect to the measurement of time on these types of matters.

Respectfully submitted,

McLaughlin & McLaughlin,
By James A. McLaughlin,
Attorneys for Appellee, Pasadena Finance Company.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAMES A. MCLAUGHLIN